RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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June 20, DJIA 869.71; PTI 1228; A-D ratio –19.15
June 27, DJIA 881.83; PTI 1238; A-D ratio –18.65

THE PICTURE: The favorite economic buzz-phrase to come out of Washington is that "This recession is bad, but it won't be as bad as 1974-75." Maybe not, but the game isn't over yet. Already, we see all kinds of records being racked up. For instance, during first quarter 1980 airline traffic dropped (on a year to year basis) for the first time in 20 years. In May new housing starts dropped to a yearly rate of 920,000 units, lowest level since 1975. Meanwhile, new home sales dropped to a 14-year low. Auto sales are now running at an adjusted annual rate of 5.5 million, the lowest rate in 20 years. New claims for state unemployment have risen to the highest level of the Post WW II era. The National Association of Purchasing Agents reports that in May their members saw fewer increases in new orders than at any time since WW II. Average farm prices are down 8% this year while farmers' expenses are up 12%. Farm income threatens to collapse in 1980 by 45%. To top this off, farmers' debt-to-income ratios are the highest since the 1930's, and farmers are in poor shape to withstand the big squeeze. Seeing and feeling the pressure, the American consumer has tried to work off his huge debt load. In April debts tumbled $1.99 billion, the first monthly decline in consumer debt in 5 years.

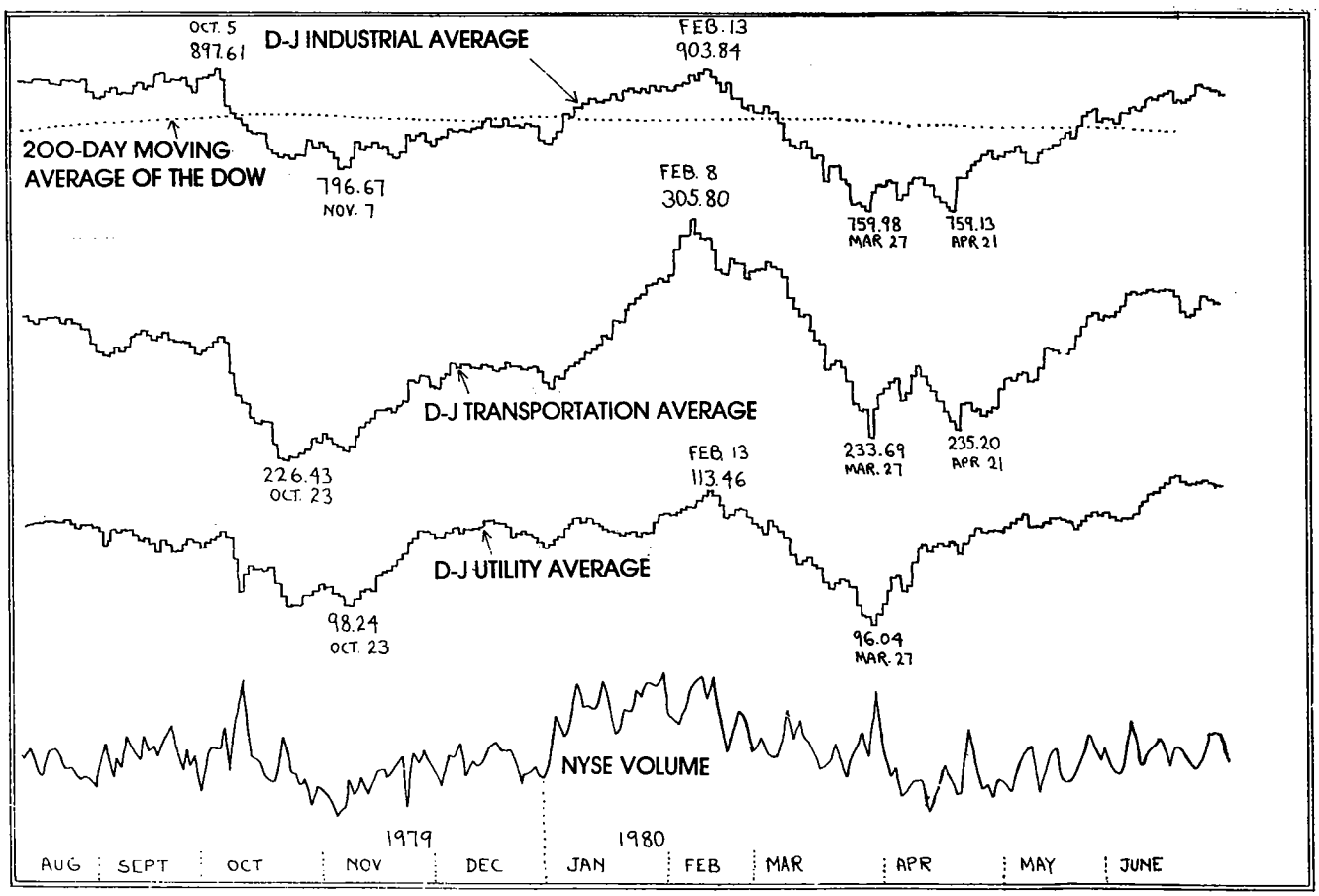
With the economy dropping like the proverbial rock, borrowing has also contracted. In response, interest rates entered into the most fantastic plunge on record with 91-day T-bill yields sinking in a matter of weeks from 16% to the 6% area. Wall Street had never seen anything like it.

All this deterioration and chaos has not been lost on Washington and our intrepid leaders. I include this clip from the June 30 US News & World Report.

> The White House is sending strong signals to Congress that it will welcome moves on Capitol Hill to spark the lagging economy by slashing taxes. It's explained that President Carter cannot openly urge a tax cut himself without appearing to reverse his position in order to get re-elected.

Meanwhile, former Treasury Secretary George Schultz has predicted that the "balanced budget" just adopted by Congress will end up as a "50 billion dollar deficit." I think Schultz is an optimist. Add the cost of rising unemployment and a big drop in government tax receipts and I believe the deficit could be nearer $75 billion. If the recession runs into 1981 we could (with the help of a $25-30 billion tax cut) run a deficit of $100 billion.

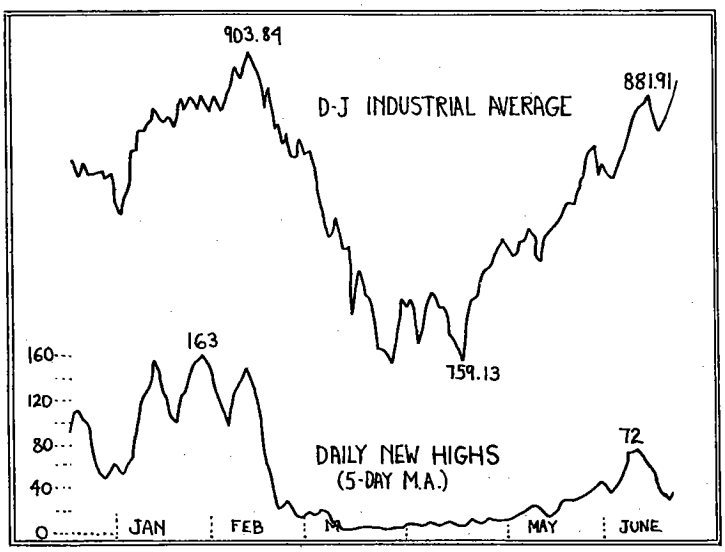
As far as the stock market is concerned, the big questions are (1) when will this recession hit bottom? and (2) how good will the upturn be?" To the casual observer, it may seem that (via the latest rally) the market has already discounted the bottom and the next expansion in business. But it should be remembered that the market truly "talks" when previous peaks are bettered



by the D-J Industrial and Transportation Averages (at least according to Dow Theory). Thus, the February 8 high of 305.80 (Transports) and the February 13 peak of 903.84 (Industrials) stand as the critical points, points that must be bettered if the "all clear" flags are to be unfurled.

But let's examine some of the most recent market action. On June 25 the D-J Industrials rallied to a high of 887.54 while Transports advanced to 275.34. From most standpoints the rally looked good. The A-D ratio was moving up nicely, the oils were leading, volume was holding near 35 million shares per day.

Two items gave me cause for concern. On June 25 the Primary Trend Index rose to a new high, but the high was far from being



confirmed by the Industrial Average (Industrials at their June 25 peak were still 16 points below the February high). I noted this in the last Letter and added that "the non-confirmation indicates that the market is tired and may need a rest before it can follow the PTI to higher ground."

The second thing I noticed was that daily new highs were lagging in May and still lagging during June. The accompanying chart shows my 5-day average of daily new highs over the last 7 months. Note that the 5-day index hit a peak of 163 on January 31. After dropping to almost zero in March, the index turned up again. But by June 14 (with the Dow pushing towards 880) the index recorded a peak of ONLY 72. From there it turned down, a strange performance.

The high-low index, however, is only one of the 8 components of the Primary Trend Index (PTI) and at this point the PTI should be studied. As you can see on the daily chart (at right) the PTI has been pushing steadily into new high territory. The persistence of the PTI advance has dragged both the Dow and the A-D ratio higher although neither has yet confirmed the breakout of the PTI. As I've said so many times, however, a PERSISTENT and RELENTLESS rise in the PTI will, in time, drag all the price and breadth indices up with it.

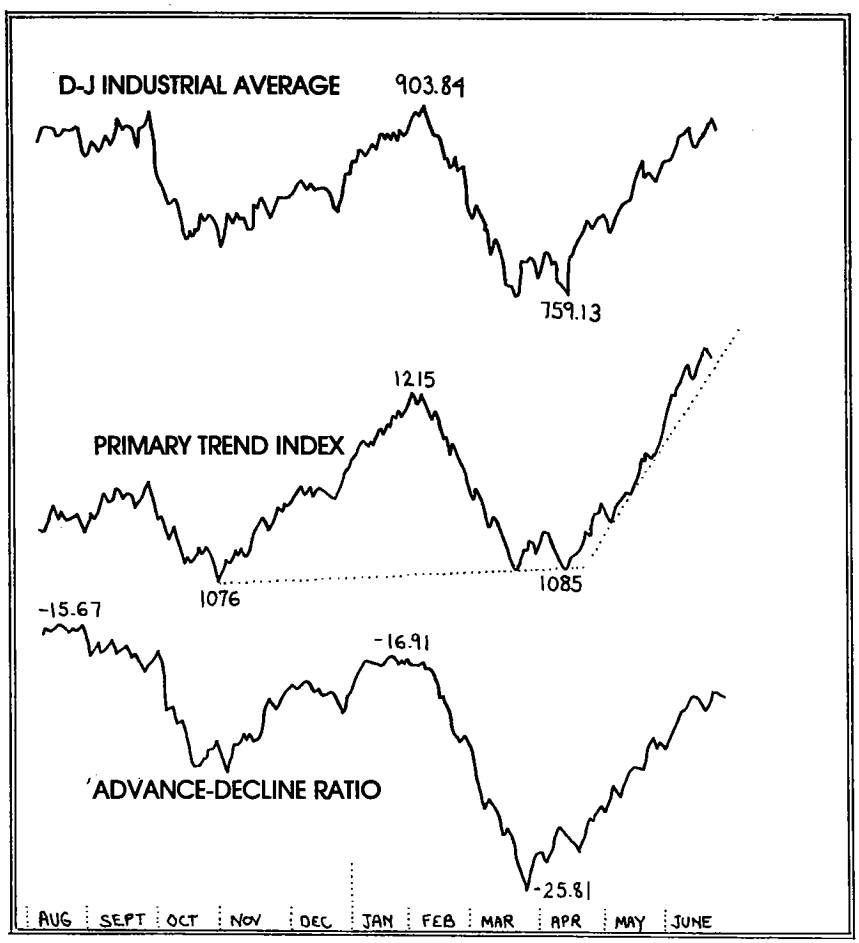
The moving averages (MA's) of the PTI were discussed thoroughly in the last Letter, and the page 3 chart shows all three MA's of the PTI in the bullish mode. The 3-week MA stands at 1231, the 8-week MA is at 1192 and the 21-week MA is at 1158. Thus, the intermediate and major trend of the PTI continues bullish. There is one "straw in the wind," however. The SPREAD between the 3- and the 8-week MA's of the PTI has bullishly widened for 12 consecutive weeks in a row. Last week, for the first time since April 3, the spread narrowed. Thus the momentum of the PTI rise is ebbing. This always happens before a decisive downturn.

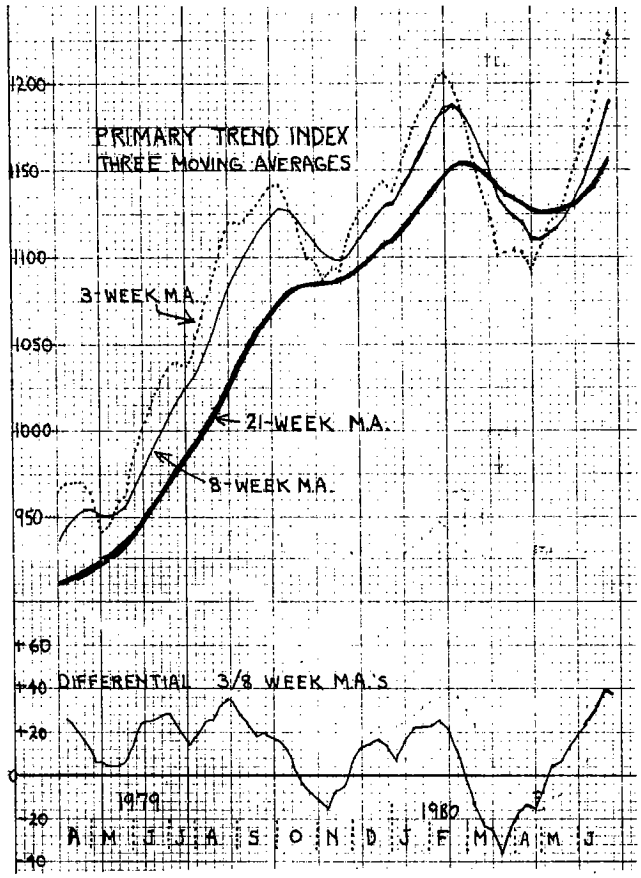
THE 233-DAY CYCLE: In Letter 781 I included a piece about the 233-day market cycle on the NYSE. This is a cycle which I have identified and which I have been following for years. The 233-day cycle contains two waves within it, an initial up-wave of approximately 144 days and a down or corrective wave of about 89 days (144 plus 89 equals 233).

Within the initial 144-day bull section of the cycle there is usually a short-term correction. This correction usually starts somewhere within the 55 to 89 day period of the up-cycle. We are at the 89-day sector of the cycle NOW, and this is the period where I would expect some corrective action to occur, but all within the up-wave section of the cycle.

I noted in Letter 781 that the current 233 day cycle turned up in March (see page 3 chart) and that if the cycle ran true to form it would top out in August. I also said that we could see some sort of corrective action during June. June is at the 89-day sector of the cycle, and this is why I believe we could have some corrective action now.

Comparing each 233-day cycle with the preceding cycle can provide us with helpful information. Often the strength (or weakness) of the market can be gauged by where succeeding cycle highs and lows arrive. For instance, note on the chart that none of the succeeding cycle highs have bettered H-1 (H-1 was the cycle peak of 1977). This is an indication of continuing weakness.





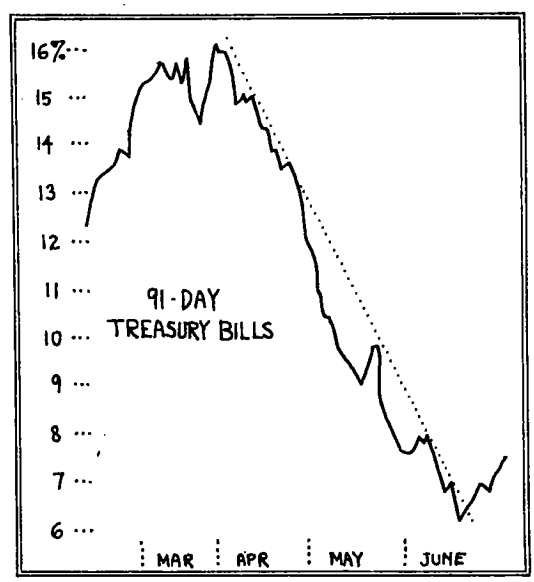
a weakness which has yet to be reversed. Note also that the 1980 cycle low at L-5 (in March) produced an intra-day Dow low which was below any cycle low on the chart. This too indicated weakness.

The big question from the cycle standpoint is whether the bull segment of the cycle will top out above or below the 1980 Dow peak (recorded on February 13) of 903.84. If the cycle tops out below 903.84, if the Dow is unable to better its preceding peak, then we will have decidedly negative indications from the cycle study. If by August the Dow is above 903.84 we will have a definite bullish indication from the cycle study.

A second indication of strength (or weakness) will be seen after the up-sector of the cycle tops out during August. At that time I will be watching to see whether any succeeding weakness (in the down-cycle) takes the Dow down below 800, or more importantly whether any weakness takes the Dow below its last cycle low of 759.98 (recorded on March 27).

RATES: This chart shows the yield (daily) for the 91-day Treasury bills, one of the bellwethers of the money market. As you can see, we had an historic drop in interest rates, from over 16% to just above 6%. During the past few weeks the bills have formed a bottom, and they have also broken their declining trendline to the upside.

In the meantime, the dollar (due to low US interest rates and rising deficits) has turned weak. My feeling is that the play on the money rates (and my subscribers captured a good deal of it) is about over. From here on, I would expect a correction of the decline. The correction could very easily regain 50% of the panic buying drop, and that would take the bills back over the 10% yield level again. Be guided accordingly.



NOTES & QUOTES: Jim Dines (Dines Letter, Box 22, Belvedere Calif. 94920) was never one to mince words. Dines, a long-term bear on the stock market, has also been a long-term bull on gold. In his latest report Dines states: "*The Dines Letter has predicted that the DJIA will get below 570.01 or that we would stop publishing this newsletter on the grounds that we do not understand the stock market. Is that specific and daring enough?*" I'd say that it was, wouldn't you!

* *

The Republican convention is only two weeks away. The polls now favor Reagan and I think (if he picks the right Vice Presidential candidate) he could win. But remember this–it's never easy to beat an incumbent Democrat. My own feeling runs something like this: I'm not sure how good a President Reagan would be, but I don't think there's any real choice. Or to put it another way: "***If Carter isn't finished, we may be!***"

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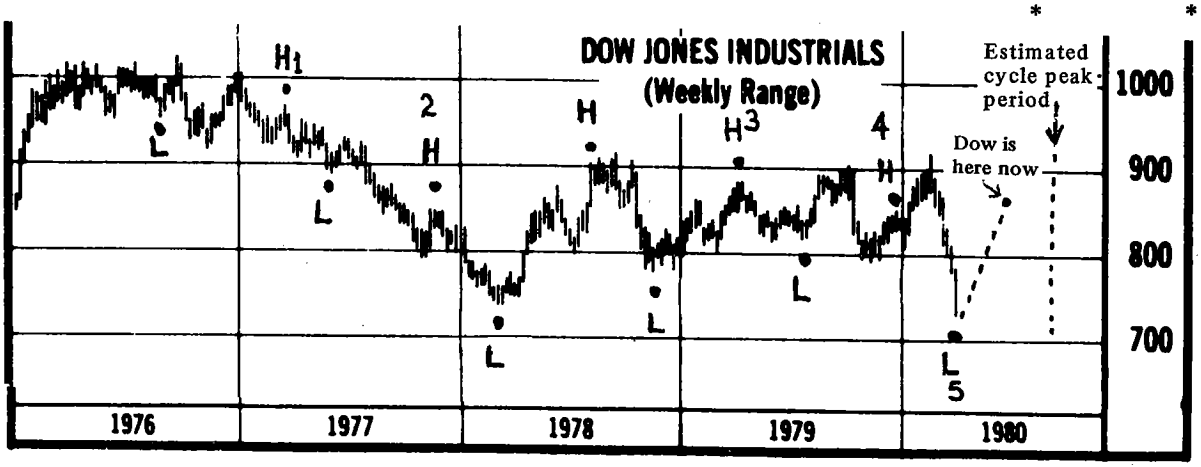


Did you know that guys who turn nuts and bolts on our auto assembly lines now get $20,000 a year and up? Did you know that the Japanese account for 30% of all autos sold in the US? Did you know that one-third of all US auto workers are now out

of work? Do you see any relationship between these three statements?

* *

Latest on the great credit-paper blizzard. Between 1973 and 1979 outstanding international loans ballooned from $320 billion to $1 trillion. Euromoney and other international credits are still going up–by far more than $100 billion a year. Late Note: the "less developed countries" will need at least $70 billion more in credits in 1980, just to pay their oil bills. Then there's the $35 billion a year that the LDC's now need to service their debts to the banks (their total debt comes to $325 billion).

* *

In case you're wondering what's happening in Gotham, here's the latest from The New York Times. A pretty nice salary boost from a city that's constantly on the edge of bankruptcy.

NEW YORK REACHES PACT WITH 25 UNIONS COSTING $1.2 BILLION

2 RAISES OF 8% EACH

Settlement With Coalition of 200,000 Employees Is Arrived at Early

By DAMON STETSON

New York City and the leaders of unions representing 200,000 municipal workers reached agreement yesterday on a contract that provides for 8 [illegible] two years.

* *

You think that Russia might do Carter a favor and pull out of Afghanistan? Forget it. This little clip from World Business Weekly (which quotes "Foreign Trade," the Soviet journal) tells you *why* you can forget it!

> the Soviet Union is Afghanistan's largest trading partner, and the two countries have agreed to increase their trade by 70% this year, which should bring it to about $862 million. Natural gas deliveries to the Soviet Union account for about 20% of Afghanistan's export earnings and are scheduled to reach 87.5 billion cubic feet this year, the journal says. The Jarkuduk gas field was commissioned this year, and work began on a new section of a natural gas trunk pipeline and on an auxiliary compressor station in the Khwaga-Gogerdag oil field.

* *

Most economists can be ignored–all but one, that is. The one is S. Jay Levy (Box 26, Chappaqua, NY 10514). When it comes to the trend of the economy, S.J. possesses a superb record. His latest report states, "We are nearing the bottom of the recession. It is likely to occur within 3 or 4 months. . . . The trends of production and retail sales, now sharply downward, will end their decline by summer's end. . . .Corporate profits will be rising at the end of 1980 . . . Inflation during 1981 will be about as bad as it was during 1978-79." And that's the good and bad from S.J.

* *

How's the Federal budget coming along? Don't ask, or go ahead (if you have the stomach for it.) The answer is in this clip. We're 8 months away and the deficit is $56 billion already. Gold, anyone?

* *

Deficit Now $56 Billion

WASHINGTON (AP)—The federal government spent $14.1 billion more last month than it collected in taxes and other revenues, the Treasury Department reported Tuesday.

The May deficit ran the government's total deficit for the first eight months of the fiscal year to $56 billion, compared with $36 billion at this same time a year ago.

How to Order Gold Medallions

Investors who want to order the Treasury gold medallions should first call this toll-free number, 800-368-5510, to obtain each day's price (based on the spot price plus a surcharge) from the Treasury.

Orders will be accepted only on order forms available at a post office, with the order date validated by a postal clerk when the order is mailed. Payment will be accepted only in the form of a United States Postal Service money order, a certified check or a cashier's check.

Medallion orders will be processed at the San Francisco mint and mailed in 8 to 12 weeks from the bullion depository at West Point, N.Y., where the medallions are being struck. Customers are requested not to ask the post office about ordering until the medallions go on sale July 15.

MEDALLIONS: The US will issue two gold medallions, a one ounce and a half ounce, each part of a five-year series. Medallions will be issued July 15 to August 30, and applications should be made at the Post Office (limit, 3 medallions of each coin per person). The medallions will be 90% gold, 10% copper, one containing 1.000 fine gold, the other .500 fine gold (the Krugerrand contains 1.000 fine gold as does the Maple Leaf). Treasury people state that the medallion is not a coin, it is not "legal tender," and therefore it could be hit with a state sales tax. The medallion will sell for the London gold fix price plus around 3% for cost of manufacturing.

I am sure there will be a big secondary market in medallions, but whether they are any better than other gold bullion coins I doubt (except as a US gold novelty). HOWEVER, these medallions do indicate one important thing. Here is the US distributing to its citizens 7.5 million ounces of gold over 5 years. Therefore, I can hardly envision the US turning around and announcing that it is again illegal for its citizens to hold gold. In other words, to me the value of the medallions is that you're buying them from the US Government. Thus, holding gold will surely remain legal in our lifetime. (Note: although the US says these medallions are not coins, it will be illegal, as with coins, for anyone to counterfeit the medallions).

IMPORTANT NOTICE: In May of 1978 I cut back from writing a Letter every 10 days (a practice which was totally exhausting me) to writing a Letter every two weeks. This was in effect, a price raise. Since then all my expenses have been steadily rising, and I guess you know this song and dance as well as I do. I've been writing these reports since 1958, and I've increased the price of subscriptions a number of times. Each time, I've included a profuse apology. I don't want to insert the usual apology now, I just want to say that I hope the added expense isn't too painful, and that if this nation ever deflates I promise to deflate the cost of Dow Theory Letters as well.

Beginning August 1 the cost of these reports will be $185 annually and $105 on a semi-annual basis. I will accept (up until

August 1) any renewals and one-year or two-year extensions of your present subscription at the old rate of $150 per year. All subscriptions are, of course, deductible for tax purposes and should be listed as an investment advisory expense.

GOLD: What is gold really worth? Dick Young (Young's World Money Forecasts, 366 Thames St., Newport, R.I. 02840) in his latest report notes that strictly as an industrial commodity, gold is worth $217 an ounce (based on an 1860 to date adjustment to commodity prices). As an international asset, says Young, gold is worth $954, based on the relationship between gold and total international monetary reserves. Finally, gold in relation to oil is now worth $808 based on an historic oil/gold ratio.

My old friend, Eliot Janeway, states that "the price of gold is political, not economic." Based on what Eliot sees coming up in the world of international politics he thinks gold is going to test or better its $850 high. The bull market in gold, he states, "has a long way to go."

C. V. Myers in his latest report notes that if the total supply of gold were distributed throughout the world, each person would have a mere ¼ ounce. C. V. believes that based on the tripling of the world's population over the last few decades, gold will eventually go well over $1000 an ounce, then settle back to around $1000 as a stabilized price.

Personally, I don't know if there is any way to measure the absolute value of gold. But I do know that gold is the world's only true money. And I do know that history indicates that ALL paper money (in due time) becomes worthless. On this basis, the *ultimate* price of gold should prove to be far above current levels. We know one fact for certain–the world mines about $17 billion worth of gold a year, while new credit in the form of paper is increasing at far over $100 billion a year. Thus, the ratio of paper to gold keeps climbing, climbing. So it isn't the long-term direction of gold which is a mystery–it's simply the timing of the moves.

GOLD STUDY: My friend, Dr. Franklin J. Kosdon of San Diego, has done a tremendous amount of work on gold, gold pricing and gold ratios. He has given me permission to reproduce (below) his single most significant chart, the price of gold adjusted by the Consumers Price Index (CPI). Using historical data, Frank has computed the past extremes of the CPI/gold ratio, and some of those extremes are shown in the insert box on the chart.

The ratio works very simply. The higher the price of gold or the lower the CPI, the lower the ratio. Actually, the ratio is a relative strength index gauging gold and the CPI. As long as gold outperforms the CPI, the ratio will decline. And the ratio has been declining on a trend basis since 1970. The implication is that gold has been a sensational inflation hedge–it has outperformed the CPI for ten years on a trend basis.

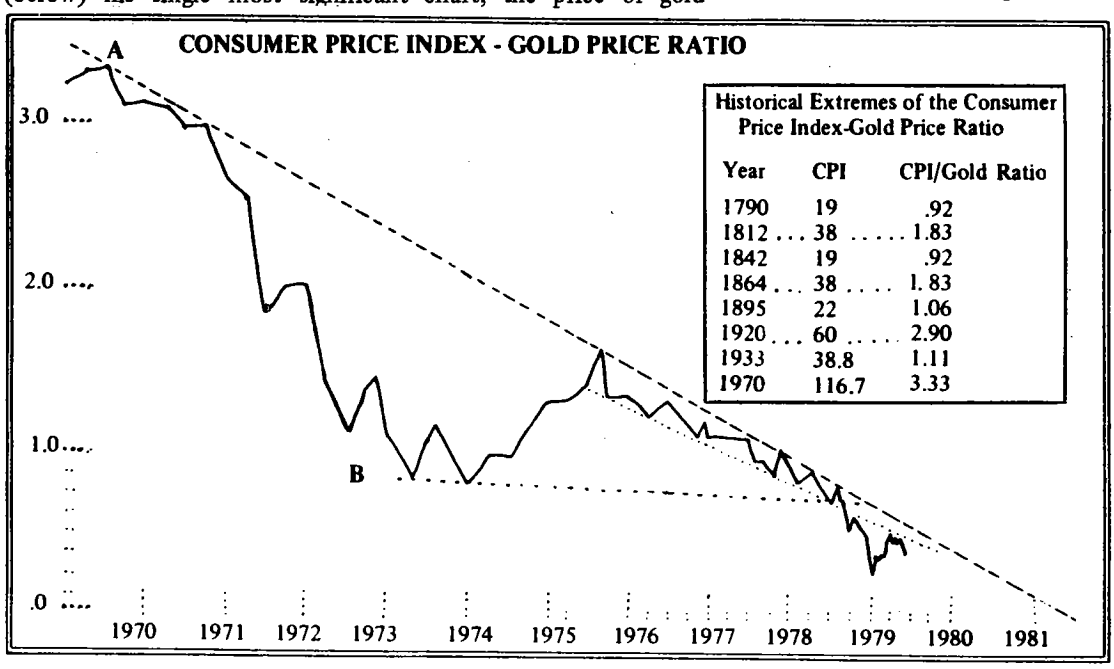
Interestingly, the highest ratio in history was recorded in 1970 at 3.33 (divide the CPI which was 116.7 by the price of gold which was $35). In charting the extreme ratio points since 1970 Kosdon was most interested to note that a major declining trend line had appeared. The validity of this trendline (A on chart) was confirmed when he noted that the ratio touched the declining trendline on many occasions. Each time the ratio touched the trendline it turned down again.

Technical support for the CPI/gold ratio was seen when a horizontal line (B on chart) was drawn through the 1974 double bottom. During mid-1979 this support at B was broken, and the result was an explosion in the price of gold. Subsequently gold corrected in price, and the ratio moved up but failed to touch trendline A. More recently, the ratio has declined again

But here is the dynamic concept of this study. Note that trend line A continues down towards zero. By mid-1982 trendline A will touch zero. The implication of zero on the ratio is that gold will rise to infinity! Of course, this will not happen, but IF trendline A continues to be respected by the ratio the implication of this study is that by mid-1982 gold will enter an upside explosion of unprecedented dimensions.

Question: Russell, what happens if, between now and 1982, the ratio moves up and pushes above trendline A, thereby reversing the trend?

Answer: In that case, the ratio would have done something that it failed to do during the previous decade. Such action would suggest that the trend of events had fundamentally changed and that one should be out of gold.



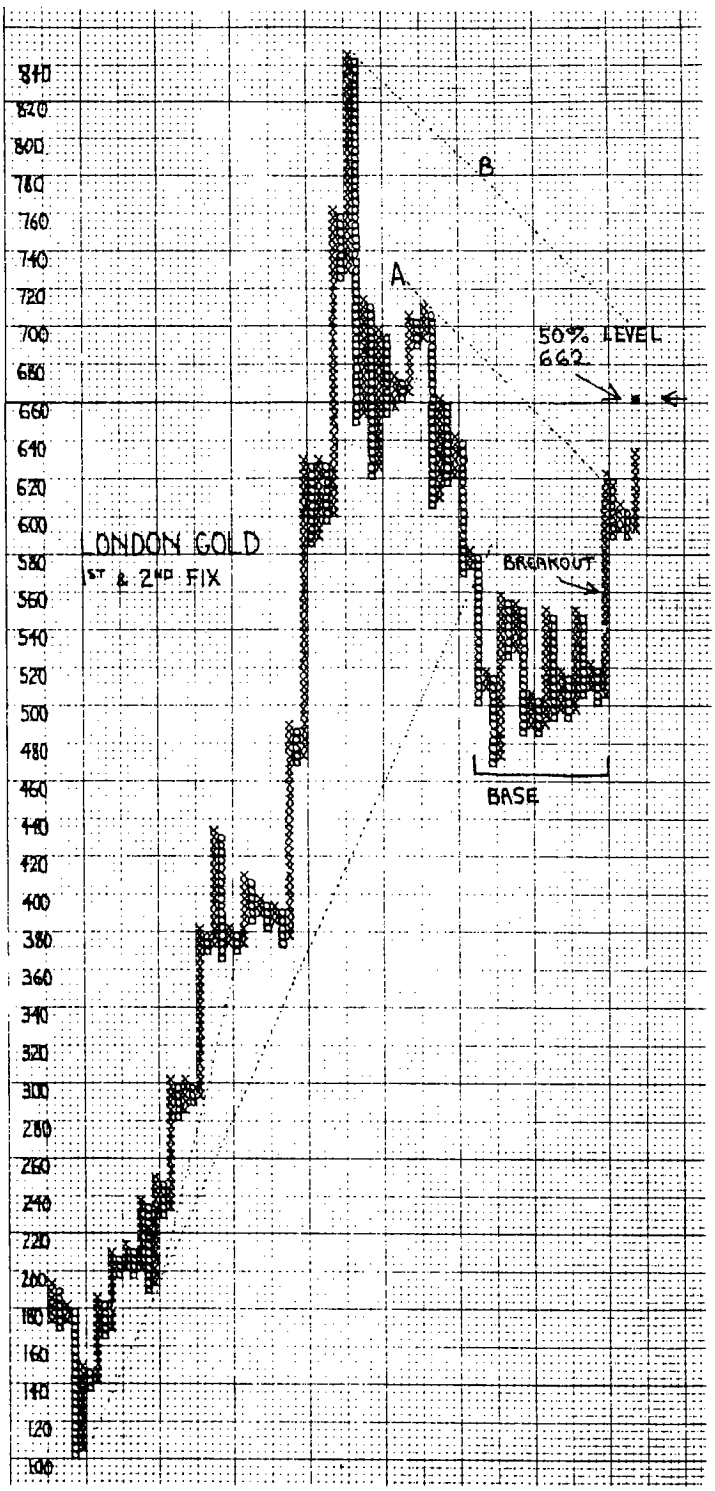
Question: All right, let's say it is late-1981, the CPI/gold ratio is dropping towards zero and gold is exploding upwards what do we do? Do we sell our gold? If so, what do we sell it for–dollars?

Answer: This is a very difficult question and one that I cannot answer now–today I would have to be closer to the event. In the event of a gold explosion, we might want to just hold our gold, we might want to diversify out of some of our gold into stocks or real estate or dollars. I simply can't say yet. But in general I would say that if we sold our gold in the midst of an upward gold explosion, we would want

to place the receipts for some of that gold in whatever item or items seemed to be the GREATEST VALUE at that particular time.

Conclusion: I feel that this is a fascinating and critical study because it introduces the TIME element into the gold equation. We know that the CPI/gold ratio must either hold below trendline A (as it sinks lower) or reverse. Either way, the outcome will be momentous for us, both as citizens of the US and as investors!

Current gold situation: All my subscribers should now have very substantial positions in gold as per instructions in recent Letters. On my latest computation the gold to NYSE common stocks *ratio* (see last Letter) rose to 959, highest level since March 9.



Thus, the momentum of relative strength *in favor of gold* is increasing (an obvious bullish indication for gold).

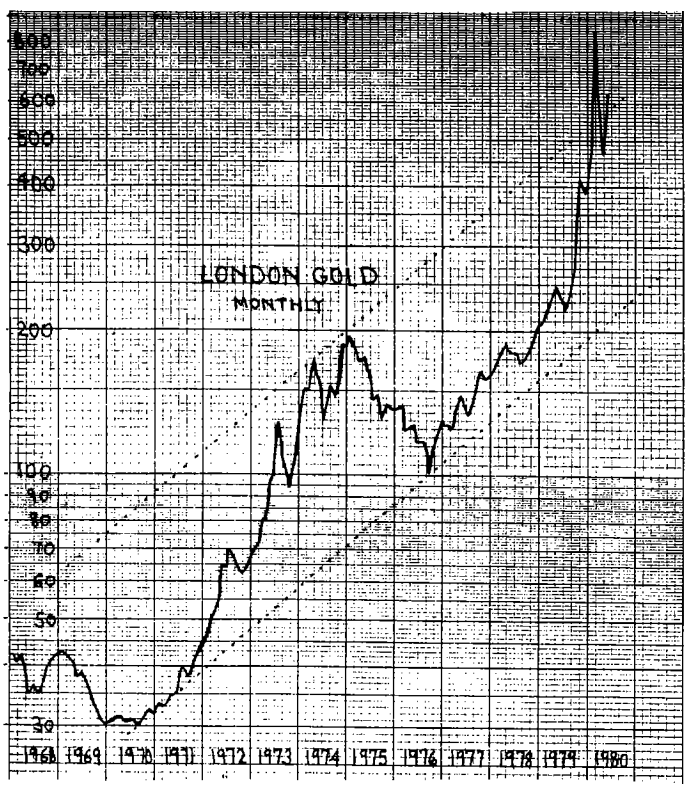
Referring to my point & figure chart for gold, note the base structure that formed in the 474 to 560 area. As stated in the last Letter, when gold bettered the 560 level (point marked "breakout" on the chart) it turned strongly bullish. Next, gold ran up to the 624 level, then backed off and reconsolidated. Note, however, that at 624 gold had reversed bearish trendline A on the chart. This bullish action allows for a test of the FINAL bearish trendline, trendline B which now intersects at the 700 level.

Of utmost importance is the 50% or halfway level of the entire correction from the 850 high to the 474 low. The 50% level is 662. The NEXT CRITICAL TEST for gold is the 662 level. If gold can close decisively above 662, it will have bullishly activated the 50% Principle, and if so a test of 700 (i.e., trendline B) will be in order. If 700 is bettered gold will be in a position to attack the 1980 high at 850.

As explained in the last Letter, the three moving averages (MA's) for gold are now in the bullish mode with the 5-week MA above the 13-week MA, and the 13-above the long-term or 50-week MA. You can see this on the page 7 chart. The current value of the 5-week MA is 593, the 13-week MA is 566, and the value of the 50-week MA is 488.

Note that during the 1980 correction (1) the 13-week MA never broke below the 50-week MA, and (2) the 50-week MA continued to advance. Both phenomena are very bullish.

As seen on this ratio chart (monthly plottings at the extremes of the moves), gold exploded above the upper channel trendline during 1979-80. Then, in early 1980, gold dropped back into the channel again. This was the time in which I would have ex-



pected a more protracted and more severe correction in gold–if it was going to occur.

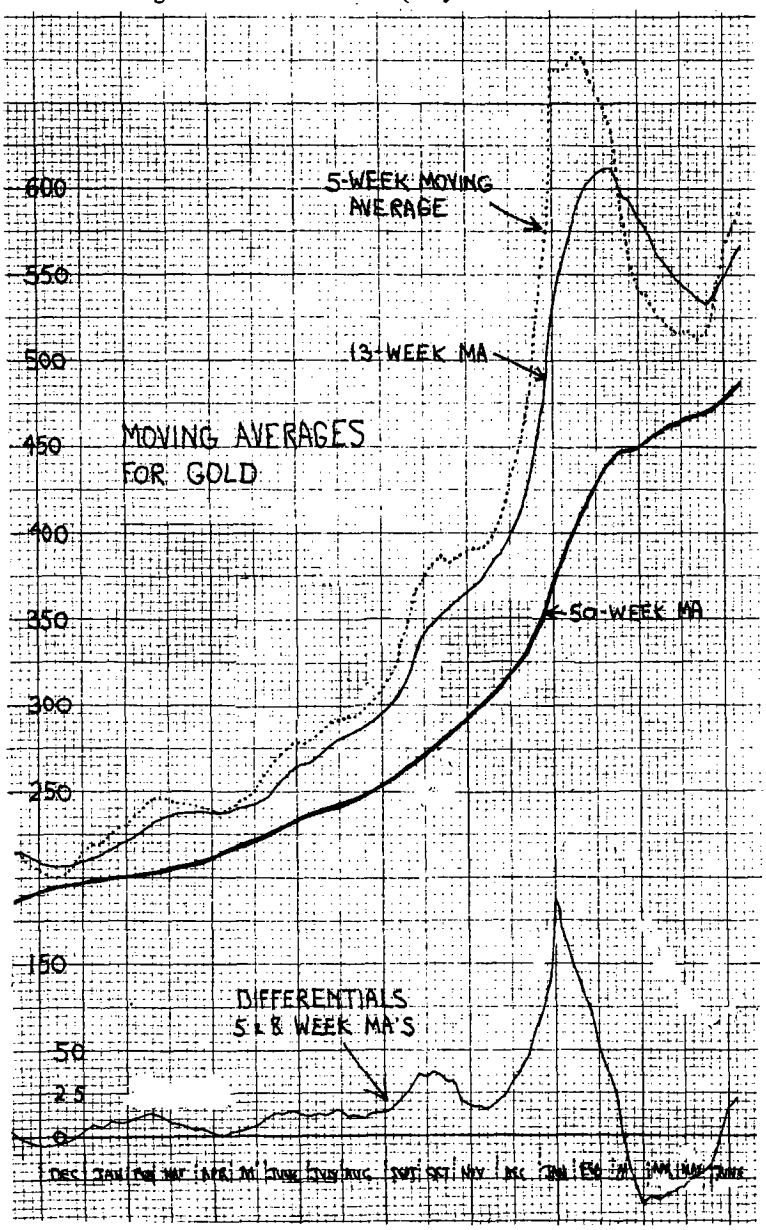
But as you can see, gold has again gathered the strength to surge above the upper channel line. Thus, from a technical standpoint I view the momentum of the 1980 explosion to 850 to be STILL INTACT.

I stated in the last Letter that in my opinion gold is now entering into the third and final phase of the great gold bull market that started in 1970-71. I am still of that opinion.

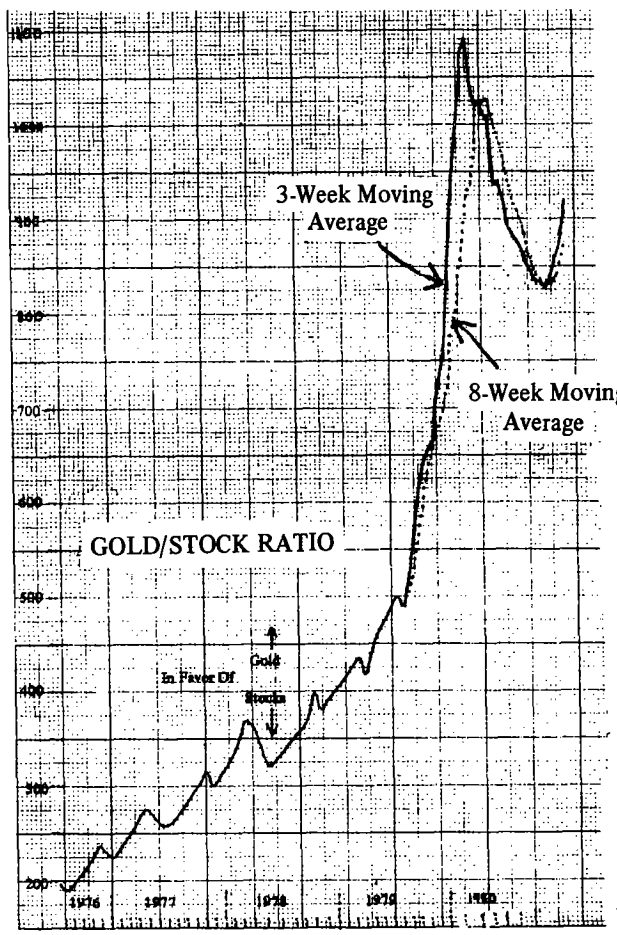
Conclusion: I have reason to believe that MOST of my subscribers are now in gold and gold related items. I have stressed the importance of gold coins as the core part of your gold position. Once you have your full coin position, you can add (according to your own inclination) gold shares or a gold fund. I can't hold each subscriber's hand, and I can't make decisions for each and every one of you. But it is important that you take a good position in gold. It is also important to avoid greed (which is buying beyond the "sleeping point"). If you buy too much you're going to sweat, and when the next correction comes you're going to panic. I continue to feel that the gold position which allows the least sweat is the gold coins themselves (they are insulated from all the mining and political problems). This is the pure gold play; no paper, no ownership papers, no certificates–just gold in the vault.

I want subscribers to understand that as the recession continues, as social unrest mounts, as political pressures build up, as the credit (debt) structure rises, more and more claims build up against the dollar and US monetary assets. It's going to take countless billions of dollars to turn this recession around, to keep the spending rolling along, to bail out the bankruptcies, to support the new military programs, to hold up the pension and transfer programs, to keep the wages rising, etc. These are the primary pressures that are sending gold up. These are the relentless pressures (and it can best be seen on the 50-week moving average) that make the yellow metal cost more and more in terms of paper money.

I know I have some subscribers who don't understand gold, some who have no feeling for gold, some who are prejudiced against it for one reason or another. To those people I say, "Go to your local library, read up on gold, learn about it, get into it." Investing and surviving in this world is a business, and it's YOUR JOB to learn your business. This is an area where no one else is going to help you, it's your problem to get over your own prejudices and blind spots!



The last chart I'm going to present in this Letter is perhaps the key chart for investing, the ratio of gold to the NYSE Composite. My latest figures show the 3-week moving average of this ratio rising to 924 while the 8-week MA is 849. This chart is saying, "The market to be in NOW is the gold market." For while stocks have been rising, gold is rising faster. It's as simple as that.



A friend called and asked, "What kind of fundamentals are causing the rise in gold?" I answered, "Mike, here are two clips from today's June 28 newspaper. Let me read them to you." And I did, and they were the same old story of deficits and debts, both national and international. I include the two clips for the edification of subscribers.

Carter Advisers Try to Catch Reagan With Own Tax Cut

From the Washington Post

WASHINGTON—President Carter's economic advisers, trying to catch up with Republican presidential contender Ronald Reagan and Senate Democrats, agreed Friday to recommend that he soon propose a tax cut of $20 billion to $30 billion effective Jan. 1.

The advisers' recommendation, reached at a meeting of the Cabinet-level Economic Policy Group, is expected to be discussed with Carter this weekend. Although the President has made no decision, he is considered likely to go along.

White House officials also won agreement from key congressional leaders late Friday to work jointly with special House and Senate Democratic task forces to develop a partywide tax-cut plan during the July 4 recess.

Oil Imports Spurt As Trade Shortfall Hits $3.96 Billion

WASHINGTON (UPI) — The U.S. trade deficit expanded in May to $3.96 billion, as oil imports surged while exports plunged by the largest amount in nearly two years, the Commerce Department said yesterday.

May's deficit was more than twice April's $1.87 billion difference betwwen imports and exports. The last surplus for the United States in international trade was $396 million in May 1976.

A persistent deficit weakens the value of the dollar in foreign exchange and contributes to domestic inflation.

WAKE UP: When I was a teenager, I wanted to be a cartoonist. Cartoonists (like fools and children) have a habit of cutting through the baloney and arriving at the truth. Of course, most people can't stomach the truth, and that's why the cartoonists use make believe, comic characters. It's much easier to accept the truth if it's presented by little characters who are silly and totally unthreatening.

The first cartoon strip probably should be dedicated to the auto industry or perhaps the steel industry. The second strip makes

the depressing point that the US continues to sell lots of sleeping pills—even if the news is hardly conducive to rest and relaxation.

* * *

I have been reading "The Selected Writings of Ralph Waldo Emerson" (who, unfortunately, is not read very often today). Emerson saw all life as a battle of opposing forces. In 1842 he wrote, "I am Defeated all the time, yet to Victory I am born." Now, there was a man!

MY ERROR: In a recent Letter I referred to the First National Bank of Chicago as a bank in trouble. They're fine; the bank that was in trouble was First Chicago Corp. Sorry . . . .

NEXT MAILING: July 16th

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